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In the Supreme Court of the United States

OCTOBER TERM, 1980

GRANT-BILLINGSLEY WHOLESALE LIQUOR CO., INC.,
Appellant,

v.

MICHAEL C. LENNEN,
SECRETARY OF REVENUE FOR THE STATE OF KANSAS, et al.,
Appellees.

On Appeal From the Supreme Court of the State of Kansas

Brief Opposing Motion to Dismiss or Affirm

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This brief replies to the motions to dismiss or affirm filed by the State of Kansas and by the intervenor/appellee Standard Liquor Corporation, the wholesaler made dominant by H.B. 2020.

I. On Its Face H.B. 2020 Defies Federal Antitrust Law.

At JS 18-20, appellant made the initial and central point that H.B. 2020 on its face patently contravenes federal antitrust law by commanding the formulation of unsupervised private territorial restraints, regardless of their effects. The State ignores this point. Standard unsuccessfully attempts to sidestep it. Standard Motion 18-19.

Standard suggests that H.B. 2020 has brought about "competitive utopia" (*id.*, 18)—hardly a surprising characterization from the viewpoint of the now dominant wholesaler whose market power is safeguarded by H.B. 2020, but an absolutely astonishing intimation from any other standpoint, especially given the record of the intensely anticompetitive effects of H.B. 2020 (*see* part IV, below). Standard's assertion not only departs from reality, it misses the point. Even under the rule of reason, the validity of airtight territorial restraints depends on a discriminating analysis of market context and circumstances and likely harms and benefits. H.B. 2020 precludes *all* analysis, of any variety, and substitutes *no* state supervision. It exonerates all ironclad territorial restraints, regardless of the circumstances. Consequently, on its face H.B. 2020 collides squarely with the Sherman Act under any test, and inquiry need proceed no further.

Standard's "second" set of contentions in this context appears at pp. 18-19 of its motion, where Standard cites the state action doctrine and the Twenty-first Amendment. The first half of this set of contentions may have been victimized by a scrivener's error. At p. 18, Standard's motion attributes to *appellant* reliance on the state action doctrine and the Twenty-first Amendment. Appellant's position is, obviously, precisely the opposite. In any event, neither the state action doctrine nor the Twenty-first Amendment provides Standard any solace against the facial invalidity

of H.B. 2020. The doctrine requires active state supervision, which is plainly absent, and, as *Midcal* establishes, the Amendment does not protect unsupervised private agreements that contravene the antitrust laws.

Standard also offers federal antitrust actions as a method for examining H.B. 2020's competitive effects (*id.*, 19), apparently as a cure for the statute's fatal facial deficiency. As noted in part IV below, the anticompetitive consequences of H.B. 2020 already have been amply demonstrated in the trial in state court in this matter. Further demonstration would be pointless (assuming any was ever needed, in light of the statute's facial invalidity), and nothing requires that such a showing must take place in federal, as opposed to state, trial court. Moreover, the complete answer to this intriguing suggestion by Standard is that states are not free to enact laws that literally defy the Sherman Act by relying on the subsequent availability of federal antitrust actions to attempt to rewrite the statute or deal with its anticompetitive consequences.

II. The State Action Doctrine Cannot Save H.B. 2020.

H.B. 2020 sets up *no* state supervision or control of the exclusive territories created by private parties; accordingly, the state action doctrine cannot save the statute. H.B. 2020 requires private restraints; the sole role of state liquor officials with regard to such restraints is to file the resultant contracts. Nonetheless, both the State and Standard assert the doctrine, the State by reference (without citation) to regulations "regarding the allocation and designation of territory" (State Motion 17) and Standard by reference to the potential for such regulations. Standard Motion 20, n. 16. Both contentions are wholly specious.

The State's principal witness, State Senator Frank Gaines (offered as an "expert" on the legislative intent behind the legis-

lation at issue) conceded at trial that H.B. 2020 provides no guidelines or safeguards for state supervision. R.T. (I) 98-99, 102. The text of H.B. 2020 (JS App. E) corroborates Gaines' concession. The only extant regulations on the point (which were promulgated *after* the trial of this matter) similarly set up *no* state supervision of the anticompetitive restraints at issue. Kans. ABC Regs. § 14-4-26, 4 CCH Liquor Control L. Rep. ¶ 6099V. Thus, the State's contention is baseless.[1]

Standard cites to a sentence from a Kansas legislative report (which it appends to its motion) "recommending" that the state ABC be empowered to review and approve all franchises. From this, Standard sees the potential for state regulations "once this litigation is finally resolved." Standard Motion 20, n. 16, and E6. This litigation has in no way impeded the promulgation of regulations, as shown by the *subsequent* promulgation of the regulations cited above. Moreover, the sentence cited by Standard is not a "recommendation" at all, and for Standard to espouse it is at least highly misleading. As is apparent from its actual text, the sentence is a description of the state franchise bill as phrased at the time the report was written. The report was prepared principally in support of state Senate Bill 28, the original Kansas franchise bill. In accord with the report statement cited by Standard, S.B. 28 contained language giving the state ABC supervisory power over franchise territories. *See* Def. Tr. Ex. 3, at 242-B, *et seq.* However, as Senator Gaines testified at trial, S.B. 28 died in committee. R.T.(I) 77-78. Components of S.B. 28 were then transferred to H.B. 2020, which started out as simply a repeal of a "sunrise-sunset" prohibition (Standard Motion E11), but which became the franchise bill actually enacted. R.T.(I) 77-78. In substituting an expanded H.B. 2020 for the unsuccessful S.B. 28, the legislature *dropped* the ABC supervisory language

1. At p. 10 of its motion, the State refers to a network of state regulation of the liquor industry in Kansas in general and confuses that with state control of the exclusive territories mandated by H.B. 2020. The statute does not give the State authority to exercise such control. Consequently, there is no state action defense.

of S.B. 28. In short, the Kansas legislature declined to enact the grant of authority to the ABC described in the report statement erroneously relied on by Standard to support its state action argument.[2]

III. Midcal Invalidates H.B. 2020.

The State and Standard both rely on the *Midcal* Twenty-first Amendment dictum about a state's "virtually complete control over . . . how to structure the liquor distribution system." *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980); State Motion 6; Standard Motion 22-23. The reliance is misplaced. Read literally, the concept of *state* control over how "to structure the liquor distribution system" does not encompass *private* territorial restraints. Moreover, as a matter of logic, the *Midcal* dictum does not exonerate a private market division scheme any more than it does the private price fixing scheme struck down in *Midcal*. Clearly, *Midcal* does not approve state authorization of liquor cartels. Yet if appellees' interpretation of the *Midcal* dictum were correct, nothing would prohibit a state from requiring distributors to agree among themselves which territories to cover. In any event, if there is uncertainty on these points, it demonstrates the presence, rather than the absence, of a substantial federal question.

To date, the Kansas Supreme Court has not published its views on the meaning of the *Midcal* dictum relied on by appellees. However, in denying rehearing after *Midcal* came down, the Kansas court apparently shared appellees' interpretation of the *Midcal* dictum as a cover for anticompetitive private conduct. By contrast, the California courts quite recently have rejected the

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2. Standard's citation of *New Motor Vehicle Bd. of California v. Orrin W. Fox Co.*, 439 U.S. 96 (1978) (Standard Motion 21) is as misguided as its treatment of the legislative report appended to its motion. For example, as Standard's own description of *Fox* notes, the statutory system in *Fox* required *prior* state approval upon a finding by state officials of good cause. Nothing like that exists in H.B. 2020. Moreover, the statute in *Fox*, also unlike H.B. 2020, did not mandate unsupervised private territorial restraints.

essence of appellees' position. *Norman Williams Co. v. Rice,* 166 Cal. Rptr. 563, *hearing denied,* Cal. Sup. Ct., Case No. 19089 (Sept. 24, 1980) (*Midcal* "distribution system" dictum covers only such basic structural matters as the creation of a licensing system for imports.)[3] The dissonance, if not square conflict, between the positions of the two state court systems on this important point illustrates the existence of a substantial federal question.

The State and Standard also contend that *Midcal* applies only to *per se* antitrust violations, and not to rule of reason cases. State Motion 8-9; Standard Motion 7-8. Neither the text nor logic of *Midcal* supports that view, but—again—any doubt on the issue presents a substantial federal question. Moreover, there is again a conflict between appellee's contention (and therefore their reading of the essence of the judgment below) and the recent ruling of the California court in *Norman Williams, supra.* Applying *Midcal,* the *Norman Williams* court struck down a state statute despite noting the absence of a recognized *per se* antitrust violation. 166 Cal. Rptr. at 569.

IV. The Record Amply Demonstrates the Anticompetitive Effects of H.B. 2020.

In a remarkable effort to disguise what was presented to the state courts, appellants assert that there has been no showing in the proceedings below and no holding by the state trial court as to the "actual competitive experience" or the "market effects" which followed the enactment of H.B. 2020. State Motion 3, 8-9, 19; Standard Motion 5, 9. The record belies this preposterous assertion.

In its opinion, the trial court declared that "(t)he effect of the exclusive franchise system authorizes private persons to engage in anti-competitive conduct and constitutes a violation of the

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3. As noted at JS 22, n. 12, the decision in *Norman Williams* is by the same California intermediate appellate court that was affirmed by this Court in *Midcal.* In the interim since the filing of the jurisdictional statement, the California Supreme Court has denied review in *Norman Williams,* thereby leaving the intermediate court as the highest state court to rule on the question.

Sherman Act." JS App. B 36a. The trial court's conclusion is supported by extensive evidence presented at the trial, which scrutinized the harmful effects of H.B. 2020 upon the wholesale liquor business in Kansas. Plaintiffs' trial counsel included Mr. Paup, a former F.T.C. staff attorney and an experienced antitrust lawyer. Plaintiffs made a well-documented showing of the immediate and severe anticompetitive effects of H.B. 2020. The jurisdictional statement repeats the evidence introduced by plaintiffs at trial, as a study of the record will indicate.

By way of illustration: To demonstrate the impact of H.B. 2020 at the wholesaler level, plaintiffs introduced into evidence the territorial agreements with suppliers entered into by Standard and Famous, the wholesalers who became dominant under H.B. 2020. These, together with plaintiff's exhibit 2, which showed the monopolistic or duopolistic wholesaler market shares created by H.B. 2020 in almost every category of spirits, and defendants' exhibit 1, official state case sale figures described by counsel for defendants as the "best evidence" of case sales to Kansas wholesalers (R.T. (I) at 16), clearly established that H.B. 2020 severely impaired competition at the wholesaler level. Indeed, plaintiffs' exhibit 2 established that under H.B. 2020 the market share of Standard and Famous together exceeded 70% in no less than nine categories of spirits.

Appellees quibble about the mechanics of how market share data were proven. Yet they have made no attempt, either at trial or subsequently, to deny that Standard's market share under H.B. 2020 is approximately 50% and that Famous has about 25% of the overall market. Pl. Tr. Exs. 2-5.

Plaintiffs also established the disastrous effect of H.B. 2020 upon those wholesalers not favored by this special interest legislation. Jack F. Grant, president of appellant, and Albert C. Becker, president of Kansas Distributors, Inc., each testified that they had lost approximately two-thirds of their business as a result of H.B. 2020 and would probably not be able to remain in business. R.T.

(I) 25-26; R.T. (II) 27-28. State Senator Frank Gaines revealed that during the legislative deliberations he was aware that one effect of H.B. 2020 would be the demise of several Kansas distributors. R.T. (I) 86.

The trial court also heard testimony at length from a highly qualified expert witness, Dr. William Terrell, as to the extensive damage done by H.B. 2020 to competition and pricing in the Kansas alcoholic beverage industry. R.T. (I) at 109, *et. seq.* Dr. Terrell's extensive work in this field was praised by the Kansas Supreme Court, which noted his special expertise. JS App. A 5a. Terrell has given testimony before the state legislature on liquor legislation; he is the economist identified in the legislative report appended to Standard's Motion. See p. E2.

Extensive evidence was also presented as to the harmful effects of H.B. 2020 on interbrand competition. The State's own official case sales data were introduced to establish the sales into Kansas of each brand in each spirits category. From these data, the market share of each manufacturer can readily be determined. These state data prove that a handful of suppliers have most of the business in the state. See JS, App. F. The brands of these dominant suppliers are, as the president of Standard conceded at trial, heavily advertised and strongly differentiated in the minds of consumers. R.T. (II) at 67-68. (Standard acknowledges this in its motion. See p. 12.) This witness further conceded that under H.B. 2020 many dominant brands within the same categories had been allocated to the same distributor. R.T. (II) 66. This evidence demonstrates that interbrand competition in the state is substantially impaired, and it was into such an environment that H.B. 2020 injected a total ban on intrabrand competition.

Appellees do not deny the existence of supplier oligopoly. As in the case of wholesaler obligopoly, they attack appellant's methodology, but do not dispute its conclusions. Moreover, at trial appellees failed to rebut plaintiffs' proof of the effects of H.B. 2020. This failure is understandable; H.B. 2020 is plainly

and simply an anticompetitive statute. That reality cannot be wiped away by bucolic conjecture about the benefits of restraints on intrabrand competition in quite different market environments.[4]

Standard complains that appellant's market share figures "do not reflect what is happening in 1980 . . . ." Standard Motion 16. Since the trial occurred in 1979, this is hardly surprising. The market share data presented were for 1979, since they were the latest official data available at the time of trial. To suggest that appellant should have presented 1980 data in a 1979 trial is absurd. However, since Standard raises the point and the State has chosen to rely on 1980 statistics outside the record, appellant is compelled to point out that the State's own official "Report Concerning Shipments of Alcoholic Liquors by Classifications and Brands from Distillers to Kansas Distributors" for fiscal 1980 demonstrates that, in one category after another, the supplier and wholesaler oligopolies which dominated the Kansas market in 1979 (see JS, App. F) still do so in 1980.

V. The State Appendices Are Outside the Record, Misleading and of No Probative Value.

The appendices to the State's motion are based upon data outside the record and which postdate trial, and are in any event of no probative value. For example, Appendix A purports to reflect a major increase in "line items" available in Kansas, since H.B. 2020 went into effect. This suggestion is grossly misleading. A "line item" is no more than a "container" or size of alcoholic beverage. State Motion App. A, p. 1. The State fails to advise the Court that the alcoholic beverage industry is currently converting to metric sizes. Thus, the recent proliferation of "line items" cited by the State demonstrates nothing more than the

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4. Standard's principal point in its motion is a rendition of *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). Standard Motion 8-9, 11-14. That rendition fails to point out that the restraint in *Sylvania* was engaged in by a firm with a no more than five percent market share and was of a less stringent type than the total ban on intrabrand competition created by H.B. 2020.

availability of familiar, old brands in numerous new metric sizes, as well as the traditional sizes.[5] Furthermore, the State's own report of shipments into Kansas for the fiscal year ending June 30, 1980 shows that there have been no significant inroads into the dominant positions of the leading suppliers in the basic spirits categories and no significant new market entries under H.B. 2020.

Appendices B-1 and 2 were supplied to the State by the Kansas chapter of the national association of wholesalers whose general counsel drafted H.B. 2020. Appendix B-1 establishes that in 33 out of 54 instances selectively cited by the State, the price of liquor under H.B. 2020 is higher than it was before the statute went into effect. This speaks for itself.

Appendix B-2 is also of no probative value. It merely establishes that in approximately half the instances selected by the State, the benefits of the state law requiring that suppliers affirm that their prices to Kansas wholesalers are the lowest available anywhere in the United States are going into the pockets of the wholesalers and are thus not being passed on to retailers or to consumers.

VI. Conclusion.

Appellees attempt to argue the merits. They fail in that attempt, but they also miss the point. They do not demonstrate the absence of a substantial federal question. To the contrary, their contentions (particularly the State's Questions Presented section of its motion) establish quite the opposite.

Despite the undisputed trial court evidence set forth in the jurisdictional statement, appellees insist that there is no record

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5. There has also been a change in a previous Kansas requirement that a supplier attest that it could supply the Kansas market for 60 days before it could ship an item into the state. Def. Tr. Ex. 3, at 302-B. This requirement has been dropped, allowing suppliers of special items, such as elaborate special edition decanters, and small "boutique" wineries, to sell a handful of cases of their products in Kansas to meet the small demand for them. This cannot be considered significant new entry.

of the actual anticompetitive effects produced by H.B. 2020. These claims are erroneous, but more importantly, both Standard and the State ignore the fundamental deficiency of H.B. 2020—its attempt to displace antitrust analysis of territorial restraints with a blanket imprimatur for their imposition. This Court has made clear that the states may not free private parties from federal antitrust requirements simply by authorizing or commanding them to engage in conduct forbidden by federal law. *Midcal,* supra, 445 U.S., at 105-06. In H.B. 2020, Kansas has done exactly that. By attempting to declare vertical restraints lawful regardless of supplier and distributor market share, and without any state mechanism for evaluating whether the utopian benefits hypothesized by Standard *may* be present, Kansas has decided that its wine and spirits industry shall be exempt from the Sherman Act. This Court's rulings show that Kansas may not so act and, rather than affirmance or dismissal, summary reversal is therefore appropriate.

Respectfully Submitted,

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